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SPECULATION ON THE STOCK EXCHANGES AND PUBLIC REGULATION OF THE EXCHANGES

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The old Farmer's Almanac used to carry at stated intervals the legend, "About this time expect rain." In the same way our almanac of industrial legislation might carry at stated intervals the legend, "About this time expect legislation in control of speculation." Demands for such legislation seem to come at intervals without any particular regularity and, so far as I can see, with no more particular reason at the special time than the reasons for the predictions in the Farmer's Almanac.

I am particularly interested in considering this question at the present time since the first article I ever wrote on an economic subject appeared in the *Political Science Quarterly* exactly twenty years ago and dealt with the subject of legislation against futures in the grain market, a subject which at that time was being very actively discussed in Congress. This is not to indicate that I have anything as interesting or romantic to relate in this brief paper as would be indicated by the title of Dumas' famous novel, *Twenty Years After*. It may be of interest, however, to this Association to know that after twenty years I still take much the same position which I took at that time. By many I am doubtless considered for this reason either a hopeless "stand-patter" or a mere professional defender of the speculative exchanges. As we grow older, however, I think we realize that the desire promptly to alter by legislation every economic institution which does not seem ideally perfect is largely characteristic of young men on the one hand and of professional legislators on the other.

During this period of twenty years certain very important experiments have been made in the way of regulation in some other countries, notably in Germany. As is well known, a most elaborate investigation was made into the subject of both stock and produce speculation by the commission which reported in 1896 and an act was passed which went into effect at the beginning of 1897. Ten years afterwards this legislation, so far as the Stock Exchange is concerned, was repealed and in the report on the act of repeal it was clearly stated by the government that the experience of ten years had shown that this well-meant

legislation had had exactly the contrary results of what had been intended.

There have also, I think, been some decided changes in this country. There have been some heated investigations by Congressional committees, there has been agitation at Albany, and there has been the well-known investigation of a much more unimpassioned nature by the Hughes Commission, of which our distinguished fellow member, Horace White, was chairman. The striking thing, to my mind, about this last investigation was that the commission had the courage of its convictions to face public criticism by not recommending any radical legislation on the part of the state. In connection with all this—whether as a result of it or in spite of it—there has been also, I think, a change of feeling on the part of responsible members of the Stock Exchange.

As a very young man I used to enjoy fulminating against the Stock Exchange at the same time that I defended it. I used to enjoy asserting, with all the air of one in authority, who could carry out his threats, that if the Stock Exchange did not take thought of itself and did not do some housecleaning on its own account it must expect radical and harmful regulation on the part of public authorities. I believe that there has really been a marked change in this direction; partly in the way of actual new rules adopted, but even more in a new temper on the part of the governing authorities towards certain practices formerly tolerated. It will be said by many that this is simply the result of the authorities of the Stock Exchange having been well scared by proposed legislation. This may be so. I am inclined to give them credit, however, for the natural growth of a new spirit in the way of recognizing that if the Stock Exchange does perform a public function its affairs can no longer be looked upon as concerning nobody but themselves, nor an investigation into its methods as in any way an impertinence. I think I speak with knowledge of the men and the situation when I say that their later efforts are not merely the efforts of criminals, conscious of their own guilt, to defend themselves, but that they are genuine efforts on the part of the enlightened and controlling element of the Stock Exchange to justify themselves as an economic institution; to really understand their own functions better; and even if necessary to reform themselves in the light of this better understanding.

If in saying this I appear as *advocatus diaboli*, I at least ask

that no one will merely assume this without an actual investigation of the facts to which I have referred; and, furthermore, that he will not do so without divesting his mind of certain fallacies regarding the Stock Exchange which are prevalent, not only in many of the efforts to regulate stock speculation by law, but also among the writings of professional economists.

Many of the old fallacies with which I tried to deal twenty years ago still prevail in the public mind,—fallacies regarding the way in which prices are formed, the real nature of supply and demand, and the extent to which the supply and demand are faithfully reflected in the open markets of our organized exchanges. But there is no time to refer to these, even if it were necessary. For this particular occasion it is more important to consider certain other fallacies which have appeared very prominently in recent years. The one I have particularly in mind is a very general fallacy as to what an exchange really is. This fallacy is to be found everywhere throughout the recent hearings before the Senate Committee on Banking and Currency and also in such a work as the recent monograph published in the *Columbia Studies* by Mr. A. A. Osborne. May I be pardoned again for making a personal reference in this case? Frankly, I shall refer more frequently to Mr. Osborne's monograph than its intrinsic value really warrants. It happens, however, that this is his thesis for the doctor's degree; that it appears in the same series in which my own doctor's dissertation appeared; that it appears just twenty years after; and that it comes to the conclusion that the theories which I ventured to put out at the earlier date, on the basis of a general study, have been disproved by a more intensive study of the facts. Perhaps I am a little hypersensitive, but I feared the casual reader might assume, because of these new conclusions being presented in the same series, that either Columbia University had taken a radically new attitude or economists in general had changed their position. I should not like any such idea to be accepted without vigorous protest on my part. It is not necessary here to consider whether or not a study of only thirty-one months of speculative activity was an adequate basis for the conclusions of this monograph. What is more important is that the work in question seems to me to reflect on almost every page exactly the same fundamental fallacy which has frequently made it so hard for legislators to understand what the problem really is.

This fallacy consists in confusing the great body of men and women who buy and sell securities, whether for investment or for speculative purposes, with the members of the organized Stock Exchange of New York. Sometimes, indeed, it would seem as if the public had confused this vast body of citizens in general, including both the conservative little investor and the great plunger, with so small a body as the governing board of the New York Stock Exchange. It is, of course, easy to use somewhat carelessly phrases such as "the function of the Stock Exchange" when what is really meant is "the function of speculation." I probably have been guilty of such careless usage myself. You can see, nevertheless, how dangerous such usage is. When the economist says that "the function of speculation is to direct the course of investment" he does not mean to say "it is the function of the Board of Governors of the New York Stock Exchange to direct the course of investment." The two are fundamentally different, and yet they are constantly being confused in the public mind. When, without careful analysis, we refer easily to the function of the Stock Exchange, what we really mean is not the function of that body as an organized group of individuals with certain officials, but the function of the New York Stock Exchange as an open market where buying and selling is carried on at the orders of a great outside public. Not to recognize this difference distinctly is as fatal to clear understanding as it would be to confuse a general statement regarding "the function of commerce" with a statement regarding "the purpose or duties of the Chamber of Commerce of the United States."

For instance, Mr. Osborne says (on page 13) that the two functions most generally ascribed by economists to a large stock exchange and preëminently to that of New York are: (1) directing the flow of capital into investments; (2) "discounting" future events. His monograph is a study of the question as to whether or not the New York Stock Exchange as an organization has done this and he comes to the conclusion that it has not. But why should it do so? What he has given as the supposed defense of the New York Stock Exchange is in reality the defense which economists have given of speculation,—that is, of an unrestrained body of speculators, who, it is true, deal largely through the New York Stock Exchange, but have nothing whatsoever to do with its membership or its organization.

It ought not to be necessary to define again in this place what

we mean by speculation. If so, it would be necessary also to define what we mean by "trade" and "commerce." It will be agreed, I suppose, that trade and commerce, the functions of which have been discussed by economists for many years, do not perform these functions with perfection or complete satisfaction. Primarily, the merchant engaged in "trade" is he who buys in one market and sells in another, whether the two markets be close together or far remote geographically. The speculator, on the other hand, is he who differentiates himself from the trader and contents himself with buying and selling in the same market with an effort to make money out of the fluctuations in price in that single market.

The true way, then, of expressing the argument is that speculation *per se* can be justified because of certain effects. By speculation *per se* I mean to mark exactly this differentiation between the speculator and the trader. The effects of such general speculation as generally accepted are already cited from Mr. Osborn's monograph; first, directing the flow of capital into investments; second, discounting future events. These two coming to much the same thing, I should still add a third, namely, the fact that a free speculative market provides a class always ready to assume the continuous risks of changes in value. In a certain passage (p. 171) Mr. Osborne seems to discard this idea, apparently quoting from something I have said. None the less I am convinced that from the investor's point of view the chances of getting rid of a security at some definite price, fixed by the speculative market, is of the utmost importance. I shall refer to this again later in connection with the closing of the Stock Exchange in the last few months.

You will see, then, that what I am trying to say is that it is essential to distinguish between our defense of speculation in general and our defense of any particular institution such as the New York Stock Exchange. The Exchange is to be defended solely as a convenience for making most effective the operation of that general speculation to which I refer. Of course, if one takes the attitude that all speculation is bad, and can be stopped and ought to be stopped, then it is easy to say, not so much that the Exchange should be regulated, but that it should be abolished. It certainly ought to be clear to everybody at the present time that stock exchanges arise as a result of speculation and the necessity among brokers of regulating their mutual relations and their relations to their clients, rather than that speculation arises as a result of stock exchanges. The problem of "stock-

jobbing" aroused attention long before there were any such things as stock exchanges. One of the earliest works of interest on this subject was published in 1719, called *The Anatomy of Exchange Alley*. Exchange Alley was simply a street where dealers in securities met, and somebody thought it worth while to analyze its "anatomy" before dealing in securities of this nature had become so important that a stock exchange was formed. I refer to this simply to emphasize the fact that it is necessary to distinguish between a judgment of speculation in general and a judgment of any exchange, whether the New York Stock Exchange or any other. We all know that besides the Stock Exchange we have the "Curb Market." During the closing of the Stock Exchange and the Curb Market we have had what is known as the "gutter market." It is quite easy to exaggerate the importance of any of these side issues in the way of speculative markets, but the fact that these arise so readily proves, at least, that our problem regarding stock exchange regulation is not the problem of whether or not speculation is desirable. Speculation exists and will continue to exist. The problem is whether the Stock Exchange as at present organized is, on the whole, the most convenient method of meeting this necessity of trade.

The trouble is, people who do not understand about it exaggerate so much the importance of the Stock Exchange,—or at least of its members. After all, they are only a body of brokers. Some of them, of course, do speculate on the side, but primarily they exist as a body of agents for the general public who, right or wrong, like to speculate in securities. They are really much more harmless men than many of their antagonists suppose; not because they desire so much to be harmless as because they are plain, ordinary agents, carrying out orders given to them by others. Very likely they would enjoy doing the terrible things which they are supposed to do and which they are charged with doing by Mr. Untermeyer and others. It would certainly be a pleasure—even if an immoral pleasure—to be quite as devilishly astute and conscienceless as they are supposed to be. As a matter of fact, they cannot do these things if they want to. In fact, they might well say to us in the words of Kipling,

We aren't no thin red 'eroes, nor we aren't no blackguards too,
But single men in barricks, most remarkable like you;
'An if sometimes our conduct isn't all your fancy paints,
Why, single men in barricks don't grow into plaster saints.

After all, is not the main question whether or not we believe in a free market for securities? And if this is the real question,—that is, if we believe in general in a speculative class and the advantages of such a class,—does it not follow that the only question is whether or not the New York Stock Exchange by its organization provides the best kind of free market? Whether its rules are such that they give you and me and thousands of others the freest right to buy and sell according to our estimates of values and furnish the best facilities for the settling of contracts? To quote Mr. Osborne again, he says, for instance (on page 170), speaking of the New York Stock Exchange in connection with the problem of how far it has proved an effective agency in the direction of the flow of capital, “Certainly in the period studied its efficient performance of this function, we concluded, was not in evidence at all, except in so far as it provided a broad market wherein any investor might buy or sell on his own initiative.”

My only reply to this statement is to ask, What else in all reason can a stock exchange be expected to do? Especially is such a reply warranted in view of the fact that somewhere else the same author suggests in a complaining tone that the New York Stock Exchange has been satisfied merely to uphold the highest standard of honor among its members.

Now, it is quite fair to argue that speculation does more harm than good. Consequently, it is fair to argue that, since an organized exchange gives an orderly form to speculation and, furthermore, facilitates the making of speculative contracts, therefore *a fortiori* the exchange is something to be suppressed. It is also a perfectly fair argument, as made by the socialists, that competitive commerce in general does more harm than good. It has also been held by thinkers of the socialistic school that banks in general and our whole credit system do more harm than good. If one wishes to adopt a proposition of this kind, one does so on quite intelligible grounds. Only, if we assume for the moment that “competitive commerce” is on the whole a good thing for society, we do not make the mistake of attributing its incidental evils to existing “chambers of commerce.”

So far I have simply been trying to point out what seems a very simple proposition; namely, that we must not confuse the general body of speculators in the country with a particular organization of brokers, who act simply as their agents. If we

believe that there should be no speculation,—that is, no buying and selling according to possible changes in value,—then we should strike at the actual source of the evil, provided it can be reached at all. At least let us not confuse a mere agency with the principal parties concerned.

From this fallacy follow two others. First, a fallacy which has appeared continuously in the hearings before Congressional committees; namely, that because certain people protest against particular government regulations which have been suggested, they consequently claim that the Stock Exchange is “above all law.” This was the kind of question that was continuously put to me, for instance, in Washington before the Senate Committee to which I have referred. Whenever I suggested that I believed that the provisions of the specific bill would do more harm than good, promptly some senator said, “Do you think these brokers are so perfect that they should be exempted from the ordinary laws of the country?” Or else such a question as this: “If we can regulate railroads, banks, and corporations, do you mean to say that there is something so sacred about the Stock Exchange that we cannot also regulate its affairs?” Obviously all such questions as these were beyond the mark. Just how far, as a matter of fact, Congress can constitutionally regulate the affairs of the Stock Exchange as easily as the affairs of railroads is a matter for the constitutional lawyer. The proposed bill itself showed the difficulties which the committee felt in that they could only reach the Stock Exchange through the right of the federal government to control the mails and, therefore, they proposed to put the stock exchanges of the country under the control of the Postmaster General. But questions of this kind are not of importance for us. Whether Congress has the constitutional right or not, there can be no question that the State of New York has the right to pass such laws as it sees fit regarding stock exchanges within its own boundaries. But here is the very point.

New York already has a great many laws, all of which apply to the members of the New York Stock Exchange as well as anybody else. There is no question of the exchanges or their members being outside the laws. They are as much subject to the laws of the state as any other set of men. An early writer warned the “stock-jobbers” of London that “the King’s writ runs in Capel Court as well as elsewhere.” Of course the King’s writ

ran in Capel Court. It always has and always will. And a New York writ runs in the supposedly sacred precincts of the Stock Exchange as effectively as elsewhere. Not only are there important statutes against fraud, against obtaining money under false pretenses, against conspiracies of one kind and another, but there are also a number of specific statutes regarding corners, "manipulation," and the like, aimed directly at the speculative market. Every member of the Stock Exchange is just as much subject to these statutes as is his client, whether the client be a small investor in a country town or a dominating financier around the corner.

A second fallacy which connects itself with the one which seems to me most important, is the fallacy that it is the *duty of the Exchange to guide investors*. Mr. Osborne's monograph, for instance, seems to be full of this idea. The same is true regarding most of the views expressed in Congressional hearings at Washington. Mr. Osborne says (p. 14): "It has never been shown either *a priori* or inductively that organized speculation in itself is the faculty of guiding investment. Unless the customs and formal rules of a particular stock exchange are established with this definite aim in view, it has never appeared that speculators will find it to their individual interest to direct or to guide investment." But where was there ever a so-called "defender of the stock exchange" who pretended for a moment that either the speculators or the brokers found it to their individual interests to carry out a function attributed to them by the economist? The very point of the whole argument has been that men who are simply following their own selfish interests with the idea of getting the most they can out of fluctuations in the market of necessity perform a certain service to the public, in the way of indicating values which it was well for the public to know. Mr. Osborne returns to this theme again and again. He insists that the New York Stock Exchange has not really assisted in directing the "flow of capital into investment" because they took no interest in this and were always so inert regarding investment orders. I know of no economist of standing who ever ventured to hold that either individual brokers on the Exchange or the governing board of the Exchange should attempt consciously to direct investment in any such way.

These conceptions all seem to me to be based upon fallacies. Once more to quote Mr. Osborne. He says (p. 150): "The

authorities of the Stock Exchange did not exert the despotic power which they have over the activities of the individual members, in seeking to adjust the volume of speculative operations to the strength of the effective investors' demand."

Now, over whom do the "authorities of the Stock Exchange" venture to assert this "despotic power"? Doubtless they have a despotic power in a certain sense over their own members which, given a good Board of Governors, is one strong argument against incorporation. But do they exert this despotic power over *us*? Cannot you and I deal on the Stock Exchange as we see fit? Is it not obvious that these brokers are, after all, merely our agents; that their powers are very much limited; that, say what one may about "insiders" and "manipulation," it is the public which makes prices? It is you and I who determine in the end what we think the value of any security to be; and who by our purchases and sales establish the price for that security which is registered on the Stock Exchange.

Once more our author refers to what he calls the fallacy of supposing that prices on the Stock Exchange are a barometer of future events. I do not propose here to make any quarrel on the question as to whether or not stock exchange prices really represent a correct and sensible guess as to what is going to happen in the future. The main point is that prices, *whether proved right or wrong in the future*, do represent with absolute exactness what we all think now.

As a substitute for the figure of the barometer, I suggest the figure of the weather vane as showing what prices on the Stock Exchange mean. It is obvious that we can easily be misled by looking at a weather vane. There is no certainty that the wind will blow indefinitely in that direction. We cannot plan either all of our planting of crops or all of our picnics in relation to the indication of the moment. The vane may change at any time. But the vane does show how the wind is blowing at a specific instant. It seems to me that the fallacy of many people who wish to change methods that provide for the smooth working of a free and open market for securities is the fallacy of one who thinks he can change the wind by interfering with the weather vane. He sees the vane pointing in a certain direction which is disappointing to him because of plans which he has made. He thinks that he can make the wind blow in a direction which is more suitable to his plans, not by changing the wind, but by changing some-

how the weather vane, and therefore he proposes to turn it in a way he likes and then put sand in it to prevent its veering with changes in the atmosphere.

I consider this figure to be entirely justified, especially in view of the idea which has been broached that the Stock Exchange has not performed its function because the "volume of speculation" and the "investment demand" do not necessarily go hand in hand. There have been periods when the amount of speculation has entirely outrun a genuine investment demand. But what does this mean? It means nothing more than that you and I—in other words, the public at large—are sometimes more in a speculative mood and at other times more in an investment mood. I cannot see the slightest reason why the two should go together. Here I might use the figure of the rain-gauge to illustrate the degree of speculative temperament in the public as shown by exchange transactions. Sometimes there is more rain than is good for the crops; sometimes there is less; sometimes the rainfall seems to be exactly what is needed. So is the relation between speculation and investment. Sometimes the public is in a speculative mood, sometimes it is more in an investing mood. To blame a body of agents who are simply carrying out transactions for the public because there is not a nice adjustment between speculation and investment seems to me as absurd as to blame a rain-gauge because it does not always show just the amount of rain which will be most desirable for the crops.

Now, it has been suggested by such an astute veteran as Mr. Untermeyer that there ought to be some right to examine the books of brokers in order to see how far manipulation is going on. On the other hand, it has been suggested by such a disinterested young scientist as Mr. Osborne that it would be very desirable if brokers were forced to make reports to the governing body of the Exchange as to the relative extent of investment and speculative orders. There are two things to be said regarding suggestions of this kind.

In the first place it ought to be recognized that half the time the broker does not know which orders are speculative and which are for investment purposes. Not only that, the purchaser himself may suddenly shift his ground; that is, what he bought today for speculative purposes, intending to sell out promptly, he may decide to hold as a wise investment. *Per contra*, he may with the best motives in the world make an investment today

and change his mind tomorrow morning, in which case his transaction would appear on the books on the face of it as a speculative transaction. The impossibility of the broker determining in any way that would do any good to the public how far his orders are speculative and how far they are for conservative investment could be illustrated at great length. But it is not necessary to carry this out further here because, even if the broker or the investigator could always tell accurately whether a given order was for speculative or investment purposes, it is thoroughly undesirable that the Stock Exchange, through its governing board or through any particular committee, should attempt to publish for the benefit of the public anything which seems to indicate which stocks are best and how prices are likely to move.

It has been suggested that a government commission should be appointed to pass upon securities and to make reports of this kind. Such a proposition is very dangerous. One thing is certain,—that the investor must make up his mind for himself. The function of the investor is of the utmost importance. In one sense he is performing a solemn duty in picking out that stock which he sincerely believes will give him the best return with a given degree of security, because he is thereby directing capital into its most profitable uses. In doing this, however, he is assisted in large measure by the existence of a free and continuous market in which both investors and speculators take part. If the speculative element were removed the market would however, not be continuous, since the buying and selling for investment purposes alone is likely to be sporadic. Values in the long run, then, and therefore the social use of capital, are determined both by those who wish to make a speculative turn out of price fluctuations and by the great mass of selfish, but shrewd and conscientious investors, who are trying to do the best with what they have. To substitute either any government agency or any action by the organized Stock Exchange in the way of attempting to solve this problem for the individual in such a way that he will feel that he can waive his own judgment in the face of what has been told him, is a proposition of the utmost danger.

It has never been maintained by a serious student of the question that the "discounting of the future" with which speculation has been credited is in any way perfect. No one has ever supposed that serious mistakes must not inevitably occur. Who could have foretold, for instance, years ago what would happen

either to the policy of the New York, New Haven, and Hartford Railroad or to the price of its stock? All I insist on is that it is far safer to leave problems of this kind to the study and foresight of the individual investor or speculator than to turn them over either to the governing board of the Stock Exchange or to any agency of the federal or state governments.

Space does not permit taking up in detail many of the suggestions which have been made for government control. A popular defense in Washington of the bill proposed about a year ago was that injury to investors could be prevented by making sure that new issues of securities represented actual values for investment purposes. As a number of senators expressed it, it was merely the application of the pure food law to securities. The phrase sounds good and it may be desirable, either by federal or state legislation, to do something in the way of making more stringent the conditions under which new companies are organized and their securities offered to the public. For instance, it has been suggested by some that the English Companies Act ought to be adopted universally in this country. The point, however, is that the English Companies Act is an act which applies to all issues, whether they are made through the stock exchange or not. The fallacy of the proposed bill was that it aimed to force certain rigid requirements regarding new issues upon the Stock Exchange through the control of the Postmaster General without in any way touching the vast number of outside securities. It would not reach in any way securities not listed on the Exchange and its effect would probably be just the reverse of that intended. There are many kinds of company shares being sold to the public today which never could get listed on the New York Stock Exchange under its present rules. Sometimes I think this is a bad arrangement. There is no place where a fraudulent issue will be so quickly detected as on the Exchange itself. But it is entirely proper for the authorities of the Exchange to make as stringent rules as they like regarding the requirements in the matter of company prospectuses. For the government, however, to attempt to discriminate between listed securities and others is likely to have just the opposite effect from that intended; namely, it would work in the direction of keeping some issues from the Exchange list which ought to be there for the double purpose of exposing them if they are illusory or fraudulent or affording them a free market if they offer proper opportunities for investment.

In all this you may say that I am talking of ideal conditions and disregard the "manipulations" which are rife on the Exchange. Again, much of interest could be said regarding either the general subject of manipulation or such specific instances as have been popularly supposed to illustrate this evil in the discussions of the last year or two. I cannot go into these. I can only reassert my conviction that, although both the outside public and the inside speculators frequently make serious mistakes in the case of certain issues, involving not only an individual but a social loss, the extent to which "rigging" or "manipulation" of the market in any destructive way is possible has been very greatly exaggerated. Furthermore, such cases can generally be met by the ordinary law governing buyers and sellers and agents in all markets. The problem cannot be understood, even in its most elementary form, unless it is recognized that it is not possible to distinguish with certainty between what are called legitimate and illegitimate transactions by the mere form of the contract. Consequently there is no way for the government, through a determination of what contracts are allowable and what contracts are not allowable, to prevent the occasional unfortunate occurrences that probably must always happen, without seriously interfering with the great volume of transactions which are not only legitimate but necessary.

If this attitude toward the problem of manipulation seems to you altogether too disregardful of prevailing evils, I can only say that I find myself in accord with such men as Sir Robert Giffen in England and our own revered Horace White. Their intimate and long experience with actual conditions and their sane appreciation of what things are possible and what things are not possible should carry far more weight with a body of economists than the excited denunciations of men who have been themselves "squeezed" in some particular deal or horrified by the recital of some unsubstantiated story.

I have spoken at such length already that I can only very briefly refer to what I had intended to make a substantial part of my paper. We have just gone through an extraordinary period in financial history, when the stock exchanges of the world have for the first time been closed for more than three months. It is a period well worth studying in connection with the theories which have formerly been advanced regarding the importance of such institutions. There are those here who can discuss this matter with more intimate experience than I.

The question may well be asked: if we got along without the Stock Exchange for more than three months, why cannot we get along without it indefinitely? If the Stock Exchange did not dare to have prices registered on its floor under free competition during this period, why is it desirable that they should be so registered at any time? The authorities, of course, had a choice of evils. If they closed the Exchange the chances were that there would be great uncertainty regarding the value of all the properties which had been dealt in. On the other hand, a crisis had here arisen. With the emergency which had come about in Europe, the dumping of foreign holdings of American securities suddenly and recklessly into our market might have led to establishing temporary prices, due merely to these emergency conditions, which would have made it impossible for any of our great investment companies, such as savings banks and insurance companies, to know anything about the ultimate value of their assets.

It has even been hinted that, regardless of the war, it would have been a good thing to close the Exchange for a while. That might possibly be true without in any way interfering with the validity of the argument. When a man gets overwrought and in an abnormal condition, from too much work or too much excitement or any other cause, it may be the best thing for him to suspend all of his ordinary economic functions and go to bed for a few days. The more serious his condition the longer must be his period of quiescence, but it does not follow from this that he can say that because he got along very well in bed for a week he might as well stay there forever. His ordinary activities and duties in the community may be temporarily suspended, but obviously this does not mean that they are of no importance in themselves.

The closing of the Exchange seems to me, then, to have proved beyond all question the importance of the open market. Everybody in this room who owns any shares of stock must have recognized that importance. The investor simply has not known the value of his property. Among us we could probably make up hundreds of cases illustrative of this. I know of one case where a conservative business man had to meet certain obligations within a given time. His bank could not carry him because the bank itself did not know the value of his collateral. Rather than beg for extension, he decided to clean his slate completely by

simply selling out certain securities which he held for investment purposes. He did this at forced sale and the very next day the purchaser sold these securities in New York at a nine point advance. This was a situation which, of course, would have been impossible had the open market been in existence. In the same way all the auction houses for securities had to go out of business. With no standard to measure by, auction sales of securities would be simply the wildest gamble.

The injurious effect, however, went far beyond the holders of securities listed on the Exchange. Not only was it impossible for bankers to tell what was the value of collateral which the borrower wished to put up, but they were in complete uncertainty as to the value of many of their own securities which they hold almost in the form of a second reserve, since these securities in normal conditions are immediately saleable and constitute the most liquid form of asset. So also the value of all kinds of outside property, not only securities but actual tangible properties, such as factories and the like, became far less certain than formerly. The whole experience was a striking illustration of the way in which all business interests are inextricably tied up together. The value of all properties is affected by the ease or difficulty with which credit can be secured and by the ease or difficulty of free investment of capital. These do not depend wholly upon the existence of an open, continuous market for securities, but depend largely upon such a market. The closing of the Stock Exchange was not solely responsible for stagnation in the matter of new investment and the normal development of new properties, but it has been a very great factor, if not the chief factor, in maintaining the continuance of such conditions.

My final conclusions, then, are as follows:

First, the events resulting from the recent closing of the exchanges of the world have justified more than ever the general economic theory as to the importance of an open speculative market for securities.

Second, past experience has quite generally proved the injurious effect of specific government interference with the rules of the Exchange. I have already referred briefly to Germany, but I have written and spoken so fully upon the results of this experiment that I will not attempt to elaborate this point here.

Third, most of the present recommendations for government regulation are based on fallacies regarding the real nature of

the Exchange; that is, the function of the Exchange authorities; or upon a fallacy regarding the relation between speculation and investment.

Fourth, where the outsider cannot tell when a regulation may wreck the legitimate, easy working of this delicate machinery, the insider can tell. The authorities of the New York Stock Exchange have made genuine efforts to bring about improvement. It is thoroughly desirable that they should recognize that the eye of the public is upon them. Possibly all this agitation has had a good effect in this direction. If it be true that in the past they preferred to live in the dark and resented any consideration of their affairs, I do not believe this is now the case.

For instance, I imagine that they would not oppose a proposition that a government representative, appointed by the Secretary of the Treasury or by the Federal Reserve Board, should become a member of their governing body. If they did so they would be very foolish. Personally, I should expect no particular change from such action except, perhaps, a greater public confidence. That experiment was tried in Germany, but had no particular effect. As a matter of fact, they are already in close touch with the best bank leaders and the government authorities regarding the proper policy for the Exchange at given times. It is well to watch them, sometimes to demand explanations or make protests. But they should be watched, not as the policeman with his club watches a furtive suspect slinking up a dark alley, but rather as any employer watches the way in which an honorable and skilled mechanic handles the delicate machinery upon the efficiency of which the success of the business depends.